

FILES

File 16:Gale Group PROMT(R) 1990-2003/Oct 03
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 File 47:Gale Group Magazine DB(TM) 1959-2003/Oct 03
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 File 148:Gale Group Trade & Industry DB 1976-2003/Oct 06
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Set	Items	Description
S1	0	(PRIC\$ (S) (MERCHANT? OR VENDOR? OR DEALER? OR DISTRIBUTOR- ?) AND (OFFER?))
S2	131518	(PRIC? (S) (MERCHANT? OR VENDOR? OR DEALER? OR DISTRIBUTOR- ?) AND (OFFER?))
S3	25833	S2 AND (REBAT? OR DISCOUNT?)
S4	1837	S3 AND ((DETERMIN? OR CALCULAT? OR SET OR SETTING OR SETS) (5N) PRICE)
S5	378	S4 AND ((CUSTOMER? OR BUYER? OR PURCHASER?) (5N) OFFER?)
S6	301	S5 NOT PY>2000
S7	137	S6 AND (PRIC? (5N) (MANUFACTUR? OR DEALER? OR SUPPLIER? OR WHOLESALE?))
S8	114	RD (unique items)
S9	87	S8 AND PRICING
S10	1221	S3 AND (NEGOTIAT? (5N) PRIC?)
S11	1221	S10 AND (REBAT? OR DISCOUNT? OR SUBSID?)
S12	778	S10 AND PRICING
S13	504	S12 NOT PY>1999
S14	18	S13 AND (PRICING () STRATEGY)
S15	462	(TRANSACTION () PRICING)
S16	99	S15 AND (REBAT? OR DISCOUNT?)
S17	27	S16 AND NEGOTIAT?
S18	8	S17 NOT PY>1999
S19	270	(PENALTY () CLAUSE)
S20	11	S19 AND (LIQUIDATED)
S21	5	S20 NOT PY>1999
S22	2634	LIQUIDATED () DAMAGES
S23	1610	S22 AND (LIQUID? (S) CONTRACT?)
S24	732	S23 AND (ONLINE OR INTERNET OR (E () COMMERCE))
S25	8	S24 AND (AUCTION?)
S26	18	S24 NOT PY>1999
S27	6536	(WARRANTY (S) MANUFACTURER)
S28	2816	(WARRANTY (5N) MANUFACTURER)
S29	7	28 AND (INCENTIVE (5N) WARRANTY)
S30	3	S29 NOT PY>1999
S31	306	(PROMOT? (5N) WARRANTY)
S32	43	S31 AND (OFFER? (4N) WARRANTY)
S33	32	S32 NOT PY>1999

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TS21/9/1

21/9/1 (Item 1 from file: 148)

DIALOG(R) File 148:Gale Group Trade & Industry DB
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08573410 SUPPLIER NUMBER: 18156966 (THIS IS THE FULL TEXT)
TPAs, insurers could pocket plan savings. (third-party administrator)
Elgin, Peggie R.
Corporate Cashflow Magazine, v17, n3, p12(2)
Feb, 1996
ISSN: 1040-0311 LANGUAGE: English RECORD TYPE: Fulltext; Abstract
WORD COUNT: 727 LINE COUNT: 00061

ABSTRACT: The Dept. of Labor (DOL) has sued Blue Cross Blue Shield for failing to remit discounts to 236 private sector health plans. DOL says that Blue Cross made dubious collections by billing the plans in excess of what they owed hospitals. As a third-party administrator for some self-insured plans from 1985 to 1992, Blue Cross amassed around \$180 million in refunds under a law that set the maximum allowable charges for hospital services. However, Blue Cross says it acted within contract stipulations with employers and that discounts are given to plan sponsors in the form of lower premiums.

TEXT:

Managed care has squeezed health care providers for handsome discounts that sometimes are pocketed by insurance companies and third-party administrators instead of flowing through to plan sponsors and participants.

Elusive discounts have led to lawsuits against Blue Cross Blue Shield, several insurance companies and some health maintenance organizations across the country.

The Department of Labor (DOL) recently sued Boston-based Blue Cross Blue Shield of Massachusetts to recover funds it believes are owed to 263 private sector health plans. The lawsuit claims Blue Cross billed the plans more than they owed the hospitals for medical services and kept the excess payments.

Those most likely to be hurt are the self-insuring plan sponsor, who doesn't get the discounts, and individuals whose copayments are based on full retail prices, says Jack Doerr, Sedgwick Noble Lowndes, Chicago.

A \$1,000 bill on which a 25% discount has been negotiated should be billed out at \$750, Mr. Doerr explains. If the hospital bills at \$1,000 instead, the majority (usually 80%) of that \$1,000 will go into the employers' claims experience rather than the majority of the \$750. The employee is charged \$200 for his 20% copayment instead of \$150.

The DOL claims that Blue Cross of Massachusetts, when it acted as a third-party administrator (TPA) for self-insured plans from 1985 to 1992, collected approximately \$180 million in refunds under a state law setting the maximum allowable charges for hospital services. Blue Cross is charged with:

- * Calculating fees on the unreduced charges rather than the lower amount paid hospitals for plans billed on a percentage of total benefit payments and

- * Inflating copayments paid by participants and beneficiaries by basing the calculations on unreduced charges.

Blue Cross argues that it is entitled to do so by its contracts with employers. Contract or no, the DOL contends the practice should be prohibited.

Some sponsors of large self-insured corporate plans have taken steps to recover their discounts. "As a self-insured employer, our practice is to

pay the net amount of provider charges after all discounts and rebates," says a General Electric spokesman. "GE sued Blue Cross of Massachusetts in 1990 for discounts due us and settled that case in 1991." Terms were not disclosed.

Mr. Doerr believes, however, that many plan sponsors are unaware of the problem despite the DOL and court activity. "Without plan audits, a sponsor won't know that the discount is not being passed on," Mr. Doerr says. "And it might sail right through the TPA."

The plan sponsor is responsible for enforcing the contract, Mr. Doerr says. "Allowing negotiated discounts to not be applied violates their fiduciary responsibility."

His advice:

- * Pay attention to the discounts negotiated with different hospitals.
- * Perform a claims audit, sampling 5-10% of the hospitals' bills.

Pamela Drellow, a spokesperson for the Blue Cross Blue Shield Association, Washington, DC, contends that when Blue Cross is the insurer it passes discounts on to plan sponsors in the form of lower premiums.

"An employer wants to know that the insurer is negotiating discounts. That is the incentive for using large insurance companies," she says.

Public officials are particularly concerned that participants are being suckered into making copayments that are based on an inflated price. "It should have occurred to somebody at Blue Cross that negotiating discounts that don't get passed through to the 20% payers would smell bad to somebody," says Greg Braden, benefits attorney at the Atlanta-based law firm of Alston & Bird. "You'd better figure out what the 20% is applied to and see that your plan makes that clear to participants," he says.

Can TPAs be trusted to pass on discounts plan sponsors have negotiated for themselves? Probably not. Mr. Braden suggests using a service to audit hospital bills. "You probably also are going to want the right to audit the administrator's books and records periodically," he adds.

"Based on the cases coming up, plan sponsors should include a liquidated damage penalty clause in their contracts," Mr. Braden adds. "That way, if you catch insurers inflating charges at the provider level or failing to pass thorough discounts, then you might collect a 25% or 50% liquidated damage penalty."

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COMPANY NAMES: Blue Cross and Blue Shield Association--Cases
INDUSTRY CODES/NAMES: BANK Banking, Finance and Accounting
DESCRIPTORS: United States. Department of Labor--Cases; Third-party administrators (Insurance)--Cases; Insurance industry--Cases
PRODUCT/INDUSTRY NAMES: 6322000 (Medical Care Insurance); 6413000 (Third Party Insurance Administrators)
SIC CODES: 6324 Hospital and medical service plans; 6411 Insurance agents, brokers, & service
FILE SEGMENT: MC File 75

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TS26/9/13

26/9/13 (Item 4 from file: 148)

DIALOG(R) File 148:Gale Group Trade & Industry DB
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09944417 SUPPLIER NUMBER: 20061524 (THIS IS THE FULL TEXT)

RM sees outsourcing challenge. (Andersen Consulting risk manager Clive Pracy)

Howard, Lisa S.

National Underwriter Property & Casualty-Risk & Benefits Management, v101, n47, p29(2)

Nov 24, 1997

ISSN: 1042-6841 LANGUAGE: English RECORD TYPE: Fulltext; Abstract

WORD COUNT: 841 LINE COUNT: 00070

ABSTRACT: Outsourcing's enormous growth presents both opportunities and challenges to risk managers, according to Andersen Consulting's Clive Pracy. In comments at the 1997 International Insurance and Risk Management Conference, Pracy suggested that risk managers should be key participants in outsourcing arrangements. Risk managers should be establishing risk control regimes even before outsourcing deals are finalized, Pracy said.

TEXT:

London

The enormous growth of outsourcing is creating challenges and opportunities for risk managers, said a risk manager for Andersen Consulting in Europe.

As more and more companies extend their global reach, they are turning to strategic alliances to provide them with the expertise they lack, said Clive Pracy, associate partner with Andersen Consulting, London.

If a company doesn't have the skill sets or geographic spread to compete in a global marketplace, and it wants to be competitive, the only options are to merge, acquire and/or outsource, he explained.

Mr. Pracy referred to a recent newspaper article he had read, which spoke of a small firm of accountants in the countryside of the United Kingdom which is doing the books for a Russian steel company via the Internet.

This is a dramatic example of the types of strategic alliances and partnerships now possible because of the great strides that have taken place in telecommunications, he said during a recent speech at the 27th International Insurance and Risk Management Conference, sponsored by Management Centre Europe, Brussels,

Andersen Consulting has moved from 20 people to 30,000 worldwide in 10 years, all involved with business-process management, "which is outsourcing by another name," said Mr. Pracy.

While all sorts of services can be provided by outsourcing, he said, typically they tend involve the whole range of support functions, such as human resources, information technology, tax and finance.

For example, in 1991 Andersen Consulting began providing "a change-management program"--a vast reengineering program--for the London Stock Exchange, he said in an interview.

Andersen took over the management of information technology systems and data processing staff and invested the savings in new IT systems, he said.

During his speech, Mr. Pracy said risk managers could and should be pivotal to an outsourcing arrangement. "Before you actually get into the deal, you should be designing and establishing and monitoring the risk control regime," he said.

"You've got to set on a culture between the two parties so they

actually understand each other and they know damn well what's going to go right end what's going to go wrong," Mr. Pracy continued.

How much insurance each partner should buy in an outsourcing alliance is not a significant issue, he said. "With alliances, your existing insurance arrangements should be sufficient as long as you've agreed on the right way to distribute the risk," he said.

"You don't start off by looking for trouble; you should make the arrangement work as a partner and not as an adversary," he explained.

A contract to set up an outsourcing alliance is critical' but has to reflect a partnership geared to performance standards and liquidated damages, rather than a typical indemnity remedy provided under a normal commercial contract, Mr. Pracy said.

(A liquidated-damage provision in a contract provides for monetary remedy without suing. It is an automatic compensation agreement between the two parties, with compensation based on a failure to perform adequately, if at all, Mr. Pracy noted.)

Further, the risk manager has to determine whether his or her company "can really play in this playground of outsourcing alliances," he said.

The risk managers of both partners to the alliance must determine whether their companies really have the right skills to fully participate in a partnership, he went on to say.

To successfully participate in the negotiations to set up an alliance, Mr. Pracy said, the risk manager must have a full range of skills, including such abilities as general business competencies, finance, strategy, process, technology, taxation and law.

He described the typical traits of outsourcing alliances:

- * They're very complicated and have huge risks and returns, particularly in regard to the reputation of both partners, he said.

He said his company has benefited in reputation from alliances with not only the London Stock Exchange, but also BP Exploration and Microsoft, although he noted later that a partner ship that goes wrong can damage a company's reputation.

- * The commitments are long-term because of the amount of money involved to set up an outsourcing partnership. He said it also takes time for the partners to get to know each other, work together smoothly and maximize the potential of the deal.

Mr. Pracy suggested that 10 years is typically the minimum investment that companies will put into these alliances.

- * It must be a partnership, not an adversarial contract, and it tends to emphasize trust and leaps of faith, he said. The relationship shouldn't be based on the idea that suing solves problems. "Nobody wins if this arrangement goes wrong, " he said later.

- * Providers of outsourcing services are not emergency-repair services or commodity providers; instead, they are members of a very extended corporate family. "These relationships are not meant to be quick fixes," he explained.

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INDUSTRY CODES/NAMES: BUSN Any type of business; INSR Insurance and Human Resources

DESCRIPTORS: Risk management--Management; Outsourcing--Management; Business consultants--Management; International Insurance and Risk Management Conference--1997

NAMED PERSONS: Pracy, Clive--Addresses, essays, lectures

PRODUCT/INDUSTRY NAMES: 7392730 (Risk Management Consulting Svcs)

SIC CODES: 8742 Management consulting services

FILE SEGMENT: TI File 148

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TS33/9/4

33/9/4 (Item 4 from file: 16)

DIALOG(R) File 16:Gale Group PROMT(R)

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04925112 Supplier Number: 47239491 (THIS IS THE FULLTEXT)

Shamrock Technology Co. establishes No. American HQ as monitor manufacturer continues market expansion; U.S. subsidiary affirms commitment by tapping new marketing and sales VP, extending warranty and offering free freight.

Business Wire, p03250030

March 25, 1997

Language: English Record Type: Fulltext

Document Type: Newswire; Trade

Word Count: 452

TEXT:

MILPITAS, Calif.--(BUSINESS WIRE)--March 25, 1997--Shamrock Technology Co. Ltd., one of the leading Taiwan-based monitor manufacturers, Tuesday announced that it has established a North American operations center here as headquarters for its Shamrock Peripherals Inc. subsidiary.

Representing a twofold increase in facilities from its former Southern California location, the new headquarters houses greatly expanded technical support staff, increased sales support personnel, room for a much more aggressive marketing program and a larger warehouse area.

The move was required to accommodate the subsidiary's rapid growth since it entered the U.S. marketplace last year at COMDEX/Fall, reported Michael Young, executive vice president of Shamrock Peripherals.

"As the customer base for our color monitor product line expands, so must our service and support," Young said. "We now have the facilities to support the high rate of growth we are experiencing. We are significantly expanding our capabilities in technical support, customer support and marketing and sales programs."

New Vice President

In affirming its commitment to North American market expansion, Young announced the appointment of industry veteran John Ochinerro as vice president of marketing and sales. Ochinerro previously co-founded monitor companies Optiquist and Orchestra Multisystems and most recently started Scanpaq, a scanner manufacturer. "John Ochinerro has a proven track record of taking a quality product, surrounding it with the necessary marketing and sales resources, and quickly becoming competitive in the North American market," said Young.

New Sales Promotion and Extended Warranty

Shamrock Peripherals also announced sales promotion efforts designed to court resellers with special pricing and services. "We are immediately offering a limited three-year warranty and free freight to anywhere in the United States based on small orders and sub-container pricing for single-unit orders," Ochinerro stated. "In addition, our entire 14-inch to 21-inch color monitor product line now includes such standard features as microprocessor-based digital or on-screen display controls, plug-and-play compatibility and Energy Star compliance."

For further information, contact Shamrock Peripherals Inc., 462 Vista Way, Milpitas, CA 95035 or telephone 888/801-8899, fax 408/934-9051, e-mail info@shamrockusa.com or visit their Web site at www.shamrockusa.com .

Company Background

Established in 1990, Shamrock Technology Co. Ltd. is publicly traded on the Taiwan Stock Exchange and had 1996 sales of \$300 million. The company is ranked among the top 10 Taiwan-based monitor manufacturers, with ISO 9002 factories in Taiwan and Malaysia capable of producing 120,000 monitors per month. Among its strategic partners is The Lion Group, a Malaysia-based multi-billion dollar conglomerate. The company also

maintains its position as one of the leading OEM suppliers of monitors for several well-known brand names.

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GEOGRAPHIC NAMES: *1USA (United States); 9TAIW (Taiwan)

PRODUCT NAMES: *3573255 (Computer Monitors)

INDUSTRY NAMES: BUS (Business, General); BUSN (Any type of business)

NAICS CODES: 334119 (Other Computer Peripheral Equipment Manufacturing)

SPECIAL FEATURES: COMPANY

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TS14/9/5

14/9/5 (Item 2 from file: 47)

DIALOG(R) File 47:Gale Group Magazine DB(TM)

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04139568 SUPPLIER NUMBER: 15799110 (THIS IS THE FULL TEXT)

The price to pay. (pricing)

Campanelli, Melissa

Sales & Marketing Management, v146, n10, p96(4)

Sept, 1994

ISSN: 0163-7517

LANGUAGE: ENGLISH

RECORD TYPE: FULLTEXT; ABSTRACT

WORD COUNT: 2459

LINE COUNT: 00194

ABSTRACT: Pricing is among the most important functions of industrial suppliers, as price tails only product quality in importance to buyers. Five techniques for effective pricing are described, including knowing when to be flexible and understanding the buyer's perception of an offer.

TEXT:

When setting prices the better managers face and solve tough decisions. Here's are five sure-fire strategies for making the pricing job easier.

Peter Hauser faces a pricing nightmare every day.

As the vice president of sales & marketing for Ultra Clean Technology Inc., a manufacturer and designer of gas distribution systems for the semiconductor industry, he sometimes has to set prices--after getting base costs from upper management--right on the spot.

Ultra Clean Technology, based in Menlo Park, California, is a two-and-a-half-year-old company in an industry where some companies and their customers have held close relationships for more than 20 years. It also sells a value-added service in an industry that is used to buying based on one thing: price.

So what goes into Hauser's snap decisions?

"Our controller and the manufacturing division give us the base costs, which include the cost of overhead, the parts, as well as the labor and engineering hours," says Hauser. "Then, the president and I will margin the price based on what the market is willing to pay and what our competitors are charging."

Since some of Ultra Clean's products cost up to 50 percent more than those of its closest competitor (average costs are between \$25,000 and \$100,000), Hauser has to allow sales reps to negotiate prices in some situations. Many times, Hauser must leave the price high, knowing that he may lose the sale.

"There are some circumstances where I have to go in with the higher price--which can be a difficult management decision," says Hauser.

For Hauser and his sales force, difficult decisions and choices are part of the pricing equation. And they are difficult whether a product is new and value-added or a commodity. Pricing isn't easy.

A recent survey by Penton Research Services indicated that price is the second most important supplier selection factor--after quality. To make makers worse, telling loyal customers that their prices may be raised next quarter can send chills up the most self-confident salesperson's spine.

Customers don't like price changes any better than salespeople or sales managers do.

"An old pricing problem is that there is no common definition of what price means and what value means--every customer and every seller has different definitions," says Dave Pugliese, president of Mesa Associates, a Glenview, Illinois-based consulting organization that specializes in price management. "The challenge for managers is to reach a price and value

definition that both are comfortable with."

Whether sales managers are setting prices with upper management or training their salespeople to do it, they must face a whole range of problems. The following secrets should help solve them:

In November, four months before the strategic planning group at Shure Brothers Inc. holds its annual business review meeting, the sales and marketing departments hold a pre-meeting session where they discuss their pricing ideas. Among other things, they iron out differences they may have about each other's pricing suggestions.

These pre-meetings are an integral part of the pricing strategy at the Evanston, Illinois-based microphone manufacturer; if the sales and marketing departments present a united front, often their pricing ideas will be approved by the planning group.

"Without these ings," says Alan Shirley, director of technical marketing and strategic planning and head of the strategic planning group, "pricing decisions might be decided by the executive committee which usually includes senior executives from the company. This can be dangerous because they're not as close to the customer as the field sales reps and managers are."

But persuading the executive committee is only half the battle. The sales and marketing departments also have to be prepared to face each other, and present logical, compelling reasons for their pricing suggestions.

For example, if the marketing department suggests to the sales department the need for a price increase for any of the company's products--such as microphones costing \$30 to \$500--it should have market share or competitive analysis data to back up the argument.

"If the sales manager rebuts this decision because, say, a direct competitor has just introduced a new, lower-priced line," says Shirley, "he should come to the meeting with a direct quote from an important dealer saying that the price would have an adverse effect on him." Then, the marketing department should call this dealer to confirm the quote. Afterward a derision could be made--as long as both parties have agreed that the price is right for the company's bottom line.

"The most productive way of setting prices," says Shirley, "is when sales and marketing work together in a structured environment."

"When you look at companies that are gaining competitive advantages because of their pricing policies," says Robert Wayland, a vice president at Mercer Management Consulting, Inc. in Lexington, Massachusetts, "it's usually the companies that have bucked the traditional pricing trends that take place in their particular industry."

Take, for example, Southwest Airlines. When Herb Kelleher started his Dallas-based airline company in the early 1970s, all of the other airline companies were setting prices on a cost-plus basis. To set fares, they used the cost of the service as the starting price and then added what they considered an adequate margin.

"One factor that was missing from this equation," says Michael Marn, a consultant with McKinsey & Co., "was what the customer wanted."

That's why Southwest opted for the far simpler approach that it still uses today: offering customers the lowest price available.

And how does it do this? Keith Taylor, director of revenue management at Southwest Airlines, who oversees all of the pricing programs says, "by closely monitoring our inventory through a yield management system. We look at such factors as demand characteristics, no-show rates, and seasonality to set prices that offer low costs to the customer and at the same time, maximize our inventory."

It's obviously working. Today, the company is positioned as the low-fare leader in the marketplace.

When Southwest first started setting prices, it also looked to a variety of different industries--not just the airlines--to see how they

keep costs low. "We didn't consider the airline companies our only competition," says Taylor. "We also took into account railways and bus companies and rental car companies."

Another example of creative, nontraditional pricing strategies is General Motors and its GM Credit Card.

Launched in September of 1992, this credit card--a MasterCard offered in partnership with Household Credit Services of Salinas, California--lets users accrue five percent of every credit card transaction into an earning account that can be transferred to the purchase or lease price of any General Motors vehicle.

According to Dave Pugliese of Mesa Associates, this pricing mechanism--which, in essence, allows users to obtain an additional price discount off any GM product--showed the general public, as well as competitors, that traditional ways to discount automobiles are not sacrosanct. "No other automobile company was experimenting with a pricing strategy like this at the time," says Pugliese, "yet the card helped GM achieve two objectives: strengthen brand loyalty and gain customers from other, competitive brands."

For some companies, there is no room to be flexible when it comes to pricing.

"Steel is sold on price," says John D. Correnti, president and chief operating officer of Nucor Corporation, the Charlotte, North Carolina-based steel manufacturer, "and in our company there is no flexibility allowed."

Each sales manager from Nucor's seven regions regularly sets prices in conjunction with the general manager of the company. "We base the price on how much it costs to run the mill to capacity twenty-four hours a day," says Correnti. "There is no discounting and no specialized deals."

And once the prices are set, Nucor does not allow its salespeople to change them.

"While salespeople have the authority to advise their customers about lower-cost freight rates, or help them get their products delivered at an earlier date, they can't set prices," says Correnti. "It's part of Nucor's culture."

And part of the nature of the steel industry. For others, changing prices and offering flexibility is the key to a good relationship with customers.

This is the case at Canton Analytical Laboratory, Inc., an environmental testing service company based in Plymouth, Michigan.

"Even though I set base prices with the president of the company by looking at the big picture and deciding what the hot trends are in the industry," says Robert Miller, sales and marketing vice president, "I also need to look at what the implications will be for the customer and for our bottom line. Therefore, sometimes I empower my salespeople to make their own decisions when pricing out in the field."

For instance, when one of Miller's six sales reps is working with a customer who has a large order, he will get volume requirements from this customer and then consult with Miller to determine a price. For smaller or medium-sized orders, however, reps are allowed to do what they need to do to please the customer.

This concept, known as transaction pricing, means that after the base price has been set by upper management, the exact price--which takes into consideration specific discounts, allowances, rebates, terms, incentives, and bonuses that are applied to each customer--is decided on a deal-by-deal basis by the sales rep or manager.

"While transaction pricing is something that companies are getting better and smarter at doing," says McKinsey's Marn, "giving reps pricing authority very often depends on the market. The more differentiated the product, the lower the risk in giving reps pricing authority."

Before instituting a transaction pricing policy, managers must convey to salespeople that dropping price shouldn't be used as a sales tool.

"I see this happening all the time," says Reed Holden, managing director of the Strategic Pricing Group, Inc. in Boston. "But the sales force shouldn't be blamed; salespeople are used to being compensated based on their ability to increase sales and are evaluated on profitability. Instead, the sales force should be trained to use pricing as a tool to reflect a product's or service's value."

Successful pricing is closely tied to an understanding of how the customer perceives a particular offering. "Very often, sales reps think they are selling one thing to the customer," says George Cressman, a consultant with E. I. DuPont de Nemours & Co., based in Wilmington, Delaware, "while the customer thinks they are buying something else." This is because there is a lack of understanding about the customer's perception of a product or service. And this goes for pricing as well. Very often, salespeople have no idea whether or not the prices they have set for their products or services match what the customer feels is the right price.

How can a salesperson uncover this information?

While research and surveys can help, the best way to truly understand how the customer perceives the value of an offering is through conjoint analysis--a dry and technical procedure that delivers colorful results.

The procedure works like this: a survey might ask participants how they feel about paying five dollars for a particular coffee cup that is a certain size. Then, the same participants are asked how they would feel about paying seven dollars for a coffee cup that is 30 percent larger, with a decorative logo on it. Finally, the participants are asked how they would feel about the larger cup, with no decorative logo, for four dollars. The participants would then rank their choices in order of preference.

With this information in hand, managers can decide how price sensitive a customer is about certain elements, and as a result can take prices up or down accordingly.

The marketing research department usually handles this procedure, but if there is no such department in a company, upper management or the sales department can purchase off-the-shelf software packages that produce summary reports revealing how much a particular customer values specific elements of an offering. (Cressman, however, warns that this process can be complex--it may be a good idea to consult an expert first.)

"When management measures this," says Cressman, "they are exploring the value the customer receives."

It's no secret that before a company sets prices, upper management should be well aware of its closest competitor's pricing scenarios. But, it should also understand its closest competitor's strategic thrust, what markets it follows, and what its technology and investment policies are.

However, competitors are traditionally quiet when it comes to proprietary information. Some companies such as computer behemoth Zenith Data Systems are even foregoing the publication of a price sheet. So, when faced with these roadblocks, what is the best way to find competitive information out?

"By establishing good relationships with current customers. They are well aware of competitor information," says Rob Stolar, director of sales at Surgical Specialties Instrument Company, Inc., an orthopedic surgical products distributor based in Odenton, Maryland. He adds that it helps to deal with the heads of the departments of these current customers, as opposed to lower-level decision-makers. These are the people who are usually in the know.

Stolar and his six reps are responsible for setting prices on a case-by-case basis. They start by looking very closely at their competition.

"When setting prices," says Stolar, "first my reps and I look at manufacturers' suggested retail prices to see what our competitors are doing, and then we delve a little deeper and ask our customers questions to see if any special deals are going on."

Then, he'll discuss this information--along with information about a particular account's pricing structure, volume requirements, and margins--with the CEO or vice president of the company. After that, he will set prices for a particular customer.

"However, in this equation competitor information is vital," says Stolar. "To be successful today as well as in the future especially in the health care industry---companies need to be aware of competitors so that they can have an edge on them."

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SPECIAL FEATURES: illustration; other

DESCRIPTORS: Pricing--Management; Industrial suppliers--Management

FILE SEGMENT: MI File 47

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TS18/9/3

18/9/3 (Item 1 from file: 148)

DIALOG(R) File 148:Gale Group Trade & Industry DB
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11586621 SUPPLIER NUMBER: 55503791 (THIS IS THE FULL TEXT)

Pricing commodities: what you see is not what you get.

Ahlberg, Johan; Hoover, William E., Jr.; Mora, Hanne de; Naucler, Tomas
McKinsey Quarterly, 3, 66(1)
Summer, 1995

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ABSTRACT: Commodities companies must resort to new strategies in sales and marketing that can lead to five to 10% of return on sales. These opportunities require that the mindset of chasing tonnage that is pervasive in commodities business be eliminated. These beliefs can only be changed by using information and incentives to transform the behavior of their sales and production organizations. They have to relax their emphasis on volume, average cost and market price and focus more on the selection of orders and customers. They also need to know the true profitability of every customer and every transaction.

TEXT:

Say goodbye to the tonnage mentality

The difference in profitability between similar orders can be 20 percent

Get the true cost of every order to both manufacturing and sales

Two case examples in steel and pulp and paper

Few commodity businesses are renowned for their marketing prowess.

How do you market a product that has virtually no differentiating features, a price that is more or less fixed, and a level of capital intensity that seems to call for chasing orders no matter what their profitability?

For many years, the answer to that question has been simple - you don't. Instead, you aimed for a low cost position and tried to run as much volume as possible past your fixed cost base. Product and service differentiation? Managing the order mix? Prioritizing customer segments? These were luxuries best left to industries where a half percent upswing in return on sales is less cause for excitement.

But the rules are changing. Successive waves of mergers, restructurings, and downsizings - not to mention a relentless focus on benchmarking - have flattened out the big differences in average costs that used to characterize such industries as pulp and paper, steel, non-ferrous metals, and transportation. Rival commodity companies of roughly the same scale now find themselves with cost curves of roughly equal slope (although factor cost differences still exist between locations and facilities). Volume, average cost, and market price are no longer the key drivers of profit, and chasing tonnage has ceased to be a viable route to profitable growth. Companies must instead turn to new approaches in sales and marketing - approaches that used to be dismissed as ineffective or inappropriate for commodity goods.

These approaches are not revolutionary. Most have long been familiar to managers in consumer goods industries. Yet applying them in commodity markets can make a dramatic impact on the bottom line. Our experience has shown that unexploited pricing and marketing opportunities exist on the order of 5 to 10 percent of return on sales opportunities that can be captured quickly and without recourse to long redesign projects or strategy rethinks.

Exploiting these opportunities will require a shift in managerial

mindset away from the traditional tonnage mentality that permeates the culture of so many commodity businesses. This mentality is the product of some of commodity marketing's most deep-rooted and pernicious beliefs about products, customers, and competitors, among them:

- * "Price is a given." Commodity marketers often believe that the same services are provided by everyone - which prevents them charging for "extras."

- * "Volume is what counts." To sales people, this means that market share trumps all other considerations: fill that volume quota or else! To production people, it means keeping the plant busy no matter what even with make-forward or make-to-stock.

- * "The competition wants the same tons as us." As all players chase all customers, commodity businesses miss a golden opportunity to cherry-pick customers and match market segments with the facilities that can best serve them.

- * "The customer only cares about price." Across-the-board cost reduction becomes king, and mix management and service elements like lead time and product quality are ignored.

Changing these ingrained beliefs will require commodity companies to use information and incentives to reshape the behavior of their sales and production organizations. It will require them to soften their focus on levers at the plant level (volume, average cost, market price), and tighten their focus on the selection of orders and customers and on the differentiation of products and services. Above all, it will require them to gain insights into the true profitability of every customer and every transaction, and to make this information transparent to production and sales. Only then can commodity companies use price to capture much of the profit that currently remains hidden.

Finding the hidden drivers of profit

The best way to start is by getting an understanding of the true order economics of your business. Contrary to conventional wisdom, price and cost in most commodity businesses vary widely between apparently similar orders. Managers' lack of information and focus on volume often lead them to overlook these variations. They thus lose the ability to distinguish between good and bad orders, and to price and manage mix accordingly.

In order to identify these variations - and to exploit the pockets of untouched profit they represent companies must shift from a plant-level view, where price is considered fixed and cost is seen purely as a function of output, to an order-by-order view, in which the true revenue and costs per order can become transparent.

The first step in discovering the true profit and cost consequences of a transaction is to break it down into a "pocket margin waterfall" (Exhibit 1). Start with the list price and begin subtracting discounts and extras to arrive at the invoice price. You may well be using invoice price to monitor your price performance. If so, you have probably failed to subtract a number of other pricing factors that diminish the actual price you receive.

These "pocket price" elements include payment terms, customer-specific rebates, and freight costs - all of which must be deducted to arrive at the pocket price, or the "true" revenue a company earns from a transaction. (*) From the pocket price, subtract the cost of making the standard product, and then deduct three crucial but often ignored cost components, namely:

- * Fall-down costs, or the extra expense of meeting the requirements of a nonstandard order. Examples include material offcuts left over from orders for nonoptimal (in terms of the plant's capability) widths, and yield losses from high-quality specifications for, say, surface and material texture. The result may be lost revenues when the excess material produced is sold as non-prime stock at a discount, or additional costs when it has to be reprocessed. Believing that it is their non-prime material

that is generating the losses, many companies fail to allocate fall-down costs to the original, apparently attractive, order.

- * Bottleneck costs, which arise in the manufacture of products that require additional processing time in a plant's bottleneck processes. The cost here is the lost contribution per throughput time of such products in comparison with the contribution that a standard product would make in the same time. The importance of bottleneck costs grows with the complexity of the manufacturing process. High-end products almost always incur bottleneck costs. A typical example of bottleneck costs is an order for thin metal products that have to be processed twice through one or more production stages.

- * Nonproduction costs, or the fixed charges and overheads that standard cost accounting systems fail to include. Examples include packaging, order handling costs, stockholding costs, and technical services.

Subtracting these neglected cost components and pocket price elements from the invoice price leaves you with the pocket margin - the true profitability of a transaction. These additional costs can represent as much as 20 to 40 percent of revenues (Exhibit 2), and sometimes vary dramatically between orders that carry identical invoice prices. They exist right along the value chain in most commodity businesses, making it vital to understand and include them at every stage, not just for the most capital-intensive processes. Who in commodities has not heard of gate price and cost?

Identifying the opportunities

Once you have developed a "true" costing method - one yielding a pocket margin that takes account of all key profit and cost drivers - you are ready to begin using your new insights to guide sales and pricing decisions. The best opportunities are usually found in three areas:

- * "Reengineering the waterfall," or improving the benefits and reducing the costs of all the elements that go to make up the pocket margin. Options might include changing the price structure (for instance, by charging for specific services or recovering freight costs), and reducing internal fall-down and bottleneck costs (Exhibit 3). Transparency can make it possible to identify and implement process improvements quickly.

- * Improving the customer and order mix by raising the profitability of every customer, adjusting the customer mix (pursuing the most profitable and abandoning the least profitable), or both. Again, the key is transparency. When a customer's full order book is made transparent, it becomes possible to improve production planning by gathering orders into bigger lot sizes (perhaps with orders from other customers), or to work with the customer to modify product specifications to streamline manufacturing. Such joint discussions of total system profitability have often revealed mutually beneficial solutions and enabled companies to establish long-term partnerships with their most attractive customers.

As the true order economics for major customers become clear, they explode the notion that all customers are equally desirable. Once disabused of this belief, a company can begin to adjust its customer mix through rebate programs, active targeting, and dropping the most unattractive customers. Its goal should be to find the customer mix that best suits its facilities and capabilities.

- * Adjusting strategic levers such as the segment and market mix and the distribution and channel structure. Commodity companies seldom use segmentation to identify and target attractive pieces of the market. Transparent order economics give them a fact-based method to determine which segments are the best fit with a given facility. They can then target the segments that yield the highest profitability, or that will pay a premium for special services such as short delivery times. Transparency enables companies to build up their strategy account by account, to decide

which products should be marketed to which customers, and to plan which price strategy to use in which geographic markets. (*)

When these previously unrealized pockets of profit along the value chain are captured, the total impact can be huge (Exhibit 4 and the boxed inserts).

Changing behavior and decision making

Sales, marketing, and production managers are often surprised to find that apparently similar orders actually differ in profitability by up to 20 percent. This discovery will overturn many of their old assumptions. Production then begins to focus on the orders that are profitable to make, while sales and marketing hones in on the products that are profitable to sell.

The aim should be to establish joint decision making between production and sales so as to strike the right balance between market realities and production capabilities. In practice, this means that both functions must have a thorough knowledge of the market and understand tradeoffs between customer needs and production capabilities, and their impact on profitability. Both functions must have accurate information (which can be provided via simple tools and systems) and working guidelines to help them balance market and production requirements. The best results are obtained when functional barriers are torn down, all unnecessary layers between sales and production are eliminated, and processes are simplified.

The key to changing behavior in the sales and marketing organization is to make information transparent and align incentives accordingly, with a new focus on pocket margin instead of revenue or volume. This will help to combat the mentality that every order is attractive, and start salespeople thinking about such issues as:

- * What part of the customer's order book should we target?
- * What opportunities are there to improve profitability for our company and the customer?
- * What delivery conditions will maximize both customer value and profitability?
- * What price policy should we adopt, and how should we manage order acceptance?

Salespeople will progress from negotiating with upstream production facilities to achieve maximum deliveries to focusing on satisfying key customers profitably. The new information at order level has the additional benefit of making sales more aware of production capabilities and limitations. It can then begin to participate in decisions on vital production issues, such as process improvements designed to help the company serve prioritized customer segments more effectively.

Production management will also have to change its behavior. It has traditionally had a strong internal focus, concentrating on maximizing output and plant yield in order to reduce cost, and making major investments to increase output. Transparent order economics - along with a growing awareness of customer needs born of fruitful dialogue with sales - will help disabuse production managers of the belief that large increases in output are all that counts, and convince them that making many small operational shifts and focused investments can add customer value. Production managers will begin to consider new issues, such as:

- * What segments should our plant focus on?
- * Which are the key customers that we would like to serve within each segment?
- * What process improvements must we make to meet the needs of our chosen customers and segments?
- * What routes to market are appropriate for these customers and segments?
- * What product revisions and innovations should we initiate?

Production decision making will gradually become informed by solid facts about performance throughout the organization, instead of internal

production data and outdated or erroneous assumptions about markets. As they begin to understand the company's true order economics, production managers will gain a comprehensive picture of every link in the value chain. This helps them avoid the trap of repeatedly reducing service levels, streamlining product offerings, and creating uniform product standards - all of which serve only to commoditize their offerings further.

The pocket margin approach

Since many companies in commodity industries measure profitability only at an aggregated level, the task of measuring it at order level may seem daunting. Moreover, sales and production sometimes seem to speak different languages, which can make it difficult for them to work together. Experience suggests that such barriers can be overcome through a simple four-stage process:

1. Establish a reliable method for calculating true order economics. A crossfunctional team made up of technical, financial, and sales or order logistics managers should be charged with this task; it is not an exercise that an accounts department can complete on its own. Companies that have already moved away from the old variance cost system to activity-based costing will have a head start.

The key is to pinpoint fall-down and bottleneck costs, which can most easily be done by working along the production process for each major product type. Using a standard product as the base, identify the additional process steps, higher yield losses, slower speed, reworks, and so on that are required to fulfill a given order. The bottleneck cost is most accurately calculated per hour of processing time; this can later be translated into a volume measure. The actual value of these bottleneck and fall-down costs can then be consolidated into a simple method showing the extra costs per process step over and above those for a standard product (ILLUSTRATION FOR EXHIBIT 5 OMITTED).

Other price elements can be established by taking a second look at standard financial information. Remember that you must include less obvious elements such as the value of payment terms, the cost of holding customer-specific stock, and so on. Once you have identified all the key profit and cost drivers and estimated their value, you can determine the pocket margin for a specific order, or the aggregated pocket margin for an entire customer segment or geographic market.

2. Make order economics transparent and accessible to key decision makers so that they can be used to guide everyday pricing, sales, and order acceptance decisions. The sales department should have access to the cost method; a simple model for simulating order and customer profitability may also be useful. Regular follow-up reports at order level will be needed for monitoring the pocket margin and key profit drivers. Order economics should be used dynamically. The pocket margin numbers must be integrated into the financial reporting system and kept up to date. And it is just as important to track achievements against the pocket margin as it is to monitor conventional productivity measures.

3. Equipped with facts about order profitability and customer needs, production and sales can now speak the same language and work together to identify opportunities for improvement. A rigorous account planning process is an effective means to this end. Since it now has detailed information at order and customer level, the sales department can start to use noncommodity pricing and marketing techniques, such as customer/order mix management, customer partnership, channel management, and effective price structures. Account plans can match the most appropriate of these tools to customer requirements, and production can direct its cost reduction and process improvement efforts to areas identified in the account plans.

Account planning is not a one-off exercise; crossfunctional teams of sales and production managers should regularly update the plans in the light of company performance and market changes. This process will put the spotlight on the profitability of the whole value chain, and lay the

foundation for continuous improvement.

4. Finally, the detailed information on order economics and key customer buying factors obtained in earlier steps can be used to review broader strategic levers, such as segment, market, and channel mix. Here again, the trick is to get sales and production to question their usual practices and jointly prioritize markets, segments, and products. Regular information sharing and intense working sessions will facilitate this process. Thorough market strategies will prove critical in guiding investment decisions that match production capabilities to customer requirements.

This four-stage approach should not be viewed as strictly sequential. Use the 80/20 rule, and get some early results to reduce skepticism and gain commitment.

Transparent order economics will allow commodity companies to challenge their old way of doing business. Some discoveries may prove embarrassing, but companies will gain productive new insights about their operations and their customers. As transparency increases their room for maneuver, many new avenues are suddenly open to them to increase profitability and to grow. And, as a few farsighted commodity companies have discovered, the benefits can be tremendous.

Between March and August 1995, the top 25 HMOs saw market value drop 25%

Power shifts in LA will soon spread to the East Coast

Playing hardball with providers will no longer work

But it's possible for HMOs to lead consolidation in a favorable direction

A TRANSPARENCY-ENABLED TURNAROUND

A European pulp and paper company had run into serious trouble, with ROS plummeting to minus 30 percent. There were obvious production inefficiencies in a recently upgraded plant, so a program was launched to cut costs and optimize production. Initially, the company focused on pure cost cutting, waiting for production to stabilize before it embarked on optimization efforts. But it soon became apparent that this strategy would yield only a couple of percent improvement in ROS.

In calculating customer, product, and order profitability, management identified additional optimization benefits from reducing complexity in the plant; these were estimated at more than 5 percent of ROS. The priority became to standardize product types and packaging and modify production planning routines. When order and customer profitability became transparent, the company was able to complement its production optimization with measures to improve transaction pricing and customer, order, and market mix. In combination, these actions had an estimated potential impact of 3 to 4 percent ROS.

The program was extremely successful, and within nine months the company was back in the black. The cost cutting had yielded a couple of percent ROS, the results of production optimization had exceeded initial estimates, and much of the customer mix potential had been captured. Together with an upturn in the market, these initiatives enabled the company's rapid turnaround. Such an impact can be achieved only when transparent order economics are used to drive changes in an organization's behavior and decision making.

CAPTURING VALUE AT STANLEY STEEL

Stanley Steel was one of its customers' favorite suppliers. Thanks to such downstream activities as customer-specific service, processing, and stockholding, the company had developed considerable flexibility and skill in customization. Typical value-added services included polishing, coating, and painting steel; supplying customized widths or lengths; meeting short lead times; coping with small and unusual lot sizes; and stockholding material for particular customers.

Yet Stanley was not enjoying a return on sales commensurate with its

popularity among customers and investors. The explanation lay in the relationship between upstream mills and downstream service and processing centers. Production did not know what capabilities these centers possessed, or even what kind of activities they performed. Nor did the centers understand what the mills could do; they simply presumed that it was always best to order standard products and do all the customizing and stockholding themselves.

As a result, the company had reached a stage where virtually all deliveries went through the service and processing centers, regardless of whether their contribution was needed to add value. A volume focus made matters worse. Both upstream and downstream operations had to take decisions without any solid information about the profitability of product offerings and customer relationships. Communication between the mills and service centers was largely confined to negotiating delivery volumes and arguing about transfer prices.

Senior management realized that something had to be done. They decided to try to establish joint direction setting in order to optimize their strengths along the value chain. As they had a poor understanding of total profitability and its drivers, they decided that their first step had to be to create transparency. This had an almost immediate impact, revealing a cluster of opportunities:

- * Transforming market channels by focusing on the end user, rather than merely the next link in the value chain. The company found, for instance, that it did not need to make deliveries daily, and quickly changed to twice weekly.

- * Pricing value-added services more appropriately - for instance, by charging for rush orders.

- * Identifying win-win opportunities with customers, such as agreeing changes in order patterns and product specifications to reduce costs for both parties. This approach allowed Stanley to discontinue certain products and keep customer stock low.

- * Managing the customer and segment mix, which helped to reduce unnecessary processing by matching orders directly at the mill. These opportunities amounted to a potential increase in return on sales of about 10 percent (see exhibit). Over half of this potential, some 5 to 7 percent ROS, was captured within six months.

What enabled this value to be captured was transparent order economics. Managers could see the financial implications of specific orders and customers along the entire value chain, rather than just in one part of the process. They were then able to judge what upstream and downstream actions to take to improve the performance of the whole business.

We would like to acknowledge the contribution of Alan Patrick, a consultant in the London office, in helping to develop the ideas discussed in this article.

- * For a fuller discussion of pocket price, see Michael V. Marn and Robert L. Rosiello, "Managing price, gaining profit," The McKinsey Quarterly, 1992 Number 4, pp. 18-37.

- * For a more detailed discussion of the marketing of commodity products, see Louis L. Schorsch, "You can market steel," The McKinsey Quarterly, 1994 Number 1, pp. 111-20.

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Managing price, gaining profit.

Marn, Michael V.; Rosiello, Robert L.

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ABSTRACT: Transaction price management is analyzed in terms of the opportunities it presents for boosting profits. Transaction price management, or price decisions at the customer-by-customer, deal-by-deal level, is often relegated to low-ranking minor managers. However, correct management of base prices, incentives and bonuses for each transaction can boost profits by a very significant margin. Two use of basic concepts of transaction price management, pocket price waterfall and pocket price band, is demonstrated using the experiences of Castle Battery Co and Tech-Craft Co.

TEXT:

Transaction prices represent one of the most attractive -- and overlooked -- opportunities to boost profits

The fastest and most effective way for a company to realize its maximum profit is to get its pricing right. The right price can boost profit faster than increasing volume will; the wrong price can shrink it just as quickly. Without realizing it, however, many managers are leaving significant amounts of money -- potential profit -- on the table at the transaction level, the point where the product meets the consumer. (*)

Most companies use invoice price as a reporting measure, but the differences between invoice and actual transaction price can mean significant reductions to bottom-line profit. Some companies that have identified this problem are handling it by applying two basic concepts: the pocket price waterfall and the pocket price band. Reduced to their essentials, these concepts show companies where their products' prices erode between invoice price and actual transaction price, and they help companies capture untapped opportunities at that level.

THE LEVERAGE and payoff of improved pricing are high. Compare, for example, the profit implications of a 1 percent increase in volume and a 1 percent increase in price. For a company with average economics, improving unit volume by 1 percent yields a 3.3 percent increase in operating profit, assuming no decrease in price. But, as Exhibit 1 shows, a 1 percent improvement in price, assuming no loss of volume, increases operating profit by 11.1 percent. Improvements in price typically have three to four times the effect on profitability as proportionate increases in volume.

With such extreme profit leverage, pricing is one function that a company can always improve. One consumer durable products company increased operating profit dollars by nearly 30 percent with a mere 2.5 percent improvement in average prices. An industrial equipment manufacturer boosted operating profits by 35 percent by carefully managing price levels up a modest 3 percent. According to our research, a wide variety of businesses, including those in consumer packaged goods, energy, and banking and financial services, have achieved comparable results.

Even if a company's managers make the right pricing decisions 90 percent of the time, it's worthwhile to try for 92 percent -- the payoff is that high. But the price lever is a double-edged sword.

The messages of Exhibit 1 also apply in reverse: a mere 1 percent price decrease for an average company, for instance, would destroy 11.1 percent of the company's operating profit dollars.

Pricing issues are seldom simple and isolated; usually they are diverse, intricate, and linked to many aspects of a business. But while most managers have a handle on the bulk of pricing issues, many overlook a key aspect of this most basic management discipline: transaction price management.

The three levels of price management

The pricing puzzle is more manageable when taken in pieces. Price management issues, opportunities, and threats fall into three distinct but closely related levels:

1. Industry supply and demand. At this highest level of price management, the basic laws of economics come into play. Changes in supply (plant closings, new competitors), demand (demographic shifts, emerging substitute products), and costs (new technologies) have very real effects on industry price levels.

Managers examining pricing in this context should understand the pricing "tone" of their markets -- that is, the overall direction of price pressure (up or down) and the critical marketplace variables fueling that pressure. This knowledge allows managers not only to predict and exploit broad price trends but also to foresee the likely impact of their actions on industry price levels.

2. Product market strategy. The central issue here is how customers perceive the benefits of products and related services across available suppliers. If a product delivers more benefit to customers, then the company can usually charge a higher price versus its competition. The trick is to understand just what factors of the product and service package customers perceive as important, how a company and its competitors stack up against those factors, and how much customers are willing to pay for superiority in those factors.

Market research tools, like conjoint analysis and focus groups, can help managers understand customer perception of benefits. And understanding at this second level of price management helps guide both the product's price positioning and the fine-tuning of product and service offerings.

3. Transactions. At this last level of price management, the critical issue is how to manage the exact price charged for each transaction -- that is, what base price to use, and what terms, discounts, allowances, rebates, incentives, and bonuses to apply. Where concern at other price management levels is directed more toward the broad, strategic positioning of products in the marketplace, focus at the transaction level of price management is microscopic -- customer by customer, transaction by transaction, deal by deal.

The three discrete levels of price management are clearly related. If, for example, a company foresees an industrywide supply shortage of its product, repositioning the product by lowering the price would be a mistake. In the same way, the product's market strategy should set the context for transaction-level pricing decisions: a move by Toyota to discount its Lexus luxury sedan at the transaction level would conflict with the market positioning of that model as a high-benefit, fair-priced alternative to competitors like Mercedes-Benz, BMW, or Jaguar.

Unfortunately, many top managers perceive transaction pricing decisions as unimportant and often relegate them to low-ranking managers or even entry-level clerks, with some flexibility at the salesforce level. By doing so, companies may be forgoing one of the most substantial profit opportunities available.

The transaction pricing opportunity

The objective of transaction price management is to achieve the best net realized price for each order or transaction. Transaction pricing is a game of inches where tens, hundreds, or even thousands of customer- and

order-specific pricing decisions daily comprise success or failure -- where companies capture or lose percentage points of margin one transaction at a time. But top management neglect, high transaction volume and complexity, and management reporting shortfalls all contribute to missed transaction pricing opportunities.

The complexity and volume of transactions tend to create a smokescreen that makes it nearly impossible for even the rare senior managers who show an interest to understand what is actually happening at the transaction level. Management information systems most often do not report on transaction price performance, or report only average prices and thus shed no real light on pricing opportunities lost transaction by transaction.

The pocket price waterfall and the pocket price band have proven valuable in lifting this smokescreen and providing a foundation to capture opportunity at the transaction level.

The pocket price waterfall

Many companies fail to manage the full range of components that contribute to the final transaction price. Exhibit 2 shows the price components for a typical sale by a manufacturer of linoleum flooring to a retailer. The starting point is the dealer list price from which an order-size discount (based on the dollar volume of that order) and a "competitive discount" (a discretionary discount negotiated before the order is taken) are subtracted to get to invoice price. For companies that monitor price performance, invoice price is the measure most commonly used.

But in most businesses, particularly those selling through trade intermediaries, invoice price does not reflect the true transaction amount. A host of pricing factors come into play between the set invoice price and the final transaction cost. Among them: prompt payment discounts, volume buying incentives, and cooperative advertising allowances.

When you subtract the income lost through these transaction-specific elements from invoice price, what is left is called the pocket price -- the revenues that are truly left in a company's pocket as a result of the transaction. Pocket price, not invoice price, is the right measure of the pricing attractiveness of a transaction.

The manufacturer offered a series of discounts and incentives that affected its product's pocket price. The company gave dealers a 2 percent payment terms discount if they paid an invoice within 30 days. It offered an annual volume bonus of up to 5 percent based on a dealer's total purchases. Retailers received cooperative advertising allowances of up to 4 percent if they featured the manufacturer's products in their advertising.

And the company paid freight for transporting goods to the retailer on all orders exceeding a certain dollar value. Taken individually, none of these offerings significantly affected profit. Together, however, they amounted to a 22.7 percent difference between the invoice and pocket prices.

Otherwise competent senior managers often fail to focus on pocket price because accounting systems do not collect many of the off-invoice discounts on a customer or transaction basis. For example, payment terms discounts get buried in interest expense accounts, cooperative advertising is included in companywide promotions and advertising line items, and customer-specific freight gets lumped in with all the other business transportation expenses. Since these items are collected and accounted for on a companywide basis, it is difficult for most managers to think about them -- let alone tally them -- on a customer-by-customer or transaction-by-transaction basis.

Exhibit 2, which shows revenues cascading down from list price to invoice price to pocket price, is called the pocket price waterfall. Each element of price structure represents a revenue "leak."

The 22.7 percent drop from invoice price down to pocket price is not at all uncommon. The average decline from invoice down to pocket price was 16.7 percent for one consumer packaged goods company, 17.7 percent for a

commodity chemical company, 18.6 percent for a computer company, 20.3 percent for a footwear company, 21.9 percent for an automobile manufacturer, and 28.9 percent for one lighting products supplier.

Companies that do not actively manage the entire pocket price waterfall, with its multiple and highly variable revenue leaks, miss all kinds of opportunities to enhance price performance.

The pocket price band

At any given point in time, no item sells at exactly the same pocket price to all customers. Rather, items sell over a range of prices. This range, given a set unit volume of a specific product, is called the pocket price band. (*) Exhibit 3 shows the flooring manufacturer's pocket price band on a dollars per yard basis for a single product.

Note that there is a 35 percent difference between the highest and lowest priced transactions. Although the width of this pocket price band may appear large, price bands that are much wider are commonplace. Pocket price bands that we examined ranged up to 60 percent for a lighting fixtures manufacturer, 70 percent for a computer peripherals supplier, 200 percent for a specialty chemicals company, and 500 percent for a fastener supplier.

Understanding the variations in pocket price bands is critical to realizing a company's best transaction pricing opportunities. If a manager can identify a wide pocket price band and comprehend the underlying causes of the band's width, then he or she can manipulate that band to the company's benefit. Recall from Exhibit 1 the huge operating profit payoff from a 1 percent increase in average price. When, as in the case of the linoleum flooring manufacturer, pocket prices vary over a 35 percent range, it's not hard to imagine how more deliberate management of such wide price variations might yield several percentage points of price improvement -- and the rich profit rewards that would accompany that improvement.

The width and shape of a pocket price band tell a fruitful story. Managers are invariably surprised not only by the width of their pocket price bands but also by the identity of customers at the extremes of the band. Customers perceived by managers as very profitable often end up at the low end of the band, and those perceived as unprofitable at the high end.

The shape of the pocket price band provides the astute manager with a graphic profile of a business -- depicting, among other things, what percentage of volume sells at deep discounts, whether there exist groups of customers who are willing to pay higher prices, and how appropriately field discounting authority is being exercised.

The Castle Battery Company case

The following, somewhat disguised, case shows how one company used the pocket price waterfall band to identify profit leaks and regain control of its pricing system. It illustrates one way in which the waterfall and band concepts can be applied, and shows how, if a company doesn't manage its pricing policies on all levels, experienced customers may be working those policies to their own advantage.

The Castle Battery Company is a manufacturer of replacement lead-acid batteries for automobiles. Castle's direct customers are auto parts distributors, auto parts retailers, and some general mass merchandisers. With return on sales averaging in the 7 percent range, Castle's profitability is very sensitive to even small improvements in price: a 1 percent increase in price with no volume loss, for instance, would increase operating profit dollars by 14 percent.

Extreme overcapacity in the battery industry and gradual commoditization made it increasingly difficult for Castle to distinguish its products from competitors'. So Castle senior management was skeptical that there was much, if any, potential for price improvement. But Castle managers had entirely overlooked lucrative pricing opportunities at the transaction level.

Exhibit 4 shows the typical pocket price waterfall for one of Castle's common battery models, the Power-Lite, sold to an auto parts retailer. From a base price of \$28.40, Castle deducted standard dealer/distributor and order-size discounts. The company also subtracted an on-invoice exception discount, negotiated on a customer-by-customer basis to "meet competition." With these discounts, the invoice price to the retailer totaled \$21.16. What little transaction price monitoring Castle did focused exclusively on invoice.

That focus ignored a big part of the pricing picture -- off-invoice discounting. Castle allowed cash discounts of 1.2 percent for timely payments by accounts. Additionally, the company granted extended terms (payment not required until 60 or 90 days after receipt of a shipment) as part of promotional programs or on an exception basis. For this transaction, the extra cost of carrying these extended receivables totaled 22 cents.

Cooperative advertising, where Castle contributed to its accounts' local advertising of Castle products, cost 85 cents. A special merchandising program in effect at the time of this transaction discounted another 60 cents. An annual volume rebate, based on total volume and paid at year end, decreased revenues by yet another 74 cents; and freight paid by Castle for shipping the battery to the retailer cost 32 cents.

The invoice price minus this long list of off-invoice items resulted in a pocket price of only \$18.18, a full 14 percent less than invoice. The total revenue drop from base price down to pocket price is the "pocket discount" -- in this case, \$10.22, of which \$2.98 was off-invoice.

Of course, not all transactions for this particular model of battery had the same pocket price. As Exhibit 5 shows, each element of the pocket price waterfall varied widely by customer and transaction, resulting in a very broad pocket price band. While the average pocket price was \$20, units sold for as high as \$26 and as low as \$14 -- plus or minus greater than 25 percent around the average. A price band like this should trigger immediate questions: What are the underlying drivers of the band's shape and width? Why are pocket prices so variable, and can that variability be positively managed?

Castle managers were surprised at the width of the price band for their Power-Lite model, but on reflection, concluded that it was due to differences in account sizes. The company had a clear strategy of rewarding account volume with lower price, rationalizing that cost to serve would decrease with account volume.

But when management examined the Power-Lite pocket prices against total account sizes for a sample of 50 accounts, it found no correlation -- it was a virtual shotgun blast. A number of relatively small accounts were buying at very low pocket prices while some very large accounts were buying at very high pocket price levels.

Castle managers, perplexed by the scatter of pocket prices by account size, launched an immediate investigation. In most cases, they found no legitimate reason why certain low-volume accounts were paying such discounted prices.

Often, they discovered that these accounts were unusually experienced and clever accounts -- customers who had been dealing with Castle for 20 years or more and who knew just whom to call at Castle headquarters to get that extra exception discount, that percentage point of additional co-op advertising, that extra 30 or 60 days to pay. These favorite old accounts were granted extra discounts based on familiarity and relationships rather than on economic justification. These experienced clients understood Castle's pocket price waterfall and were working it against the company.

Castle senior management realized that its transaction pricing process was out of control, that decision making up and down the waterfall lacked discipline, and that no one was focusing on the comprehensive total of those decisions. The end result was a pricing reality that didn't square

with Castle's strategy of rewarding account size with lower prices, and that was costing Castle millions.

To correct its transaction pricing situation, Castle mounted a three-part program. First, it took very aggressive corrective actions to bring the overdiscounted, "old favorite" accounts back in line. Management identified the problem accounts and explained the situation and its impact on overall company profits to the salesforce. Then the company gave the salesforce nine months to fix or drop those outliers.

Fixing meant decreasing the excessive discounting across the waterfall so that outlier accounts' pocket prices were more in line with those of accounts of similar size. Salespeople who couldn't negotiate their outlier pocket prices up to an appropriate level were to find other accounts in their territory to replace them.

Within the time allotted, the salesforce fixed 90 percent of the trouble accounts. Sales' newfound realization that every element of the waterfall represented a viable negotiating lever contributed to this success. And, in most cases, the salespeople easily found profitable replacements for the other 10 percent.

Second, Castle launched a program to stimulate volume in larger accounts that had higher than average pocket prices compared with accounts of similar size. Management singled out the attractive "target" accounts for special treatment. Sales and marketing personnel investigated them carefully to determine the nonprice benefits to which each was most sensitive. The company increased volume in these accounts not by lowering price but by delivering the specific benefits that were most important to each: higher service levels for some, shortened order lead times for others, more frequent sales calls for still others.

Finally, Castle embarked on a crash program to get the transaction pricing process back under control. This program included, among other components, setting clear decision rules for each discretionary item in the waterfall. For example, the company capped exception discounts at 5 percent and granted them only after a specific volume and margin impact evaluation.

Management also set up new information systems to guide and monitor transaction pricing decisions. And Castle established pocket price as the universal measure of price performance in all of these systems. It began to track and assign, transaction by transaction, all of the significant off-invoice waterfall elements that were previously collected and reported only on a companywide basis. Further, pocket price realization became a major component of the incentive compensation of salespeople, sales managers, and product managers.

Castle reaped rich and sustained rewards from these three transaction pricing initiatives. In the first year, average pocket price levels increased 3 percent and, even though volume remained flat, operating profits swelled 42 percent. The company realized additional pocket price gains in each of the two subsequent years.

Castle also received some unexpected strategic benefits from its newfound transaction pricing capability. Account-specific pocket price reporting revealed a small but growing distribution channel where Castle pocket prices were consistently higher than average. Increasing volume and penetration in this emerging channel became one of Castle's key strategic initiatives this past year. The fresh and more detailed business perspective that Castle senior managers gained from their transaction pricing involvement became the catalyst for an ongoing stream of similar strategic insights.

The Tech-Craft Company case

Consider another case -- one that takes an even finer cut than the Castle example. Here, top management used both the pocket price waterfall and the pocket price band as broader tools. The company not only assimilated valuable information about its pricing policies but also used that knowledge to manipulate its pricing system and influence its

retailers. The Tech-Craft Company took the waterfall and band and extended the concept, successfully applying the lessons of a financial tool to benefit its marketing strategy.

Tech-Craft is a manufacturer of home appliances, with microwave ovens as its primary line. Tech-Craft sells its microwave ovens directly to appliance retailers and a variety of mass merchandisers and department stores. With dozens of major and minor brands available, the microwave market is highly competitive and most retail outlets carry multiple brands.

Very complex price structures had evolved over the years in this competitive market. Exhibit 6 shows the average pocket price waterfall (on a percentage of dealer list price basis) for a Tech-Craft transaction to an appliance retailer. The company gave a total pocket discount of 39.1 percent over 11 different waterfall elements.

Research into competitors' pricing practices revealed that most competitors' price structures were just as complex as Tech-Craft's but varied in form -- particularly off the invoice. For example, they varied by cash discount terms, co-op advertising rates, volume bonus discounts, volume break points, and freight payment policies. The variety and complexity of price structures made it somewhat difficult for appliance retailers to compare microwave prices among competitors.

Further research showed that most retailers used just invoice price minus cash discount as their yardstick for comparing prices, taking for granted most of the off-invoice items. So a dollar discount on the invoice had much more impact on the retailer's buying decision than a dollar off the invoice.

With this knowledge, Tech-Craft managers made a simple price structure change to one product line. They took their largest off-invoice discount -- the annual volume bonus -- and shifted it to on-invoice. To do this, they estimated each account's annual purchases at the beginning of the year, paid the volume bonus on the invoice based on that estimate, and then made an end-of-the-year adjustment if necessary. The result was an 11 percent increase in same-store volume, not by deeper discounting but rather by tailoring the pocket price waterfall so that Tech-Craft's price reflected the criterion that retailers used in comparing prices.

The result so intrigued Tech-Craft managers that they researched their pocket price waterfall even further, discovering evidence that retailers were not equally sensitive to price changes across all elements of the waterfall. For example, they found that retailers were much more sensitive to a \$1 change in the national promotion discount than to a \$1 change in the order-size discount, despite the fact that they affected Tech-Craft's pocket price equally. Tech-Craft managers used such insights regarding dealers' unequal sensitivity to different pieces of the waterfall to alter their pricing approach in several areas.

First, when they wanted to lower price to stimulate volume, Tech-Craft managers adjusted the waterfall elements to which their retailers were most sensitive -- thus engendering the maximum volume growth. Conversely, when they wanted to raise price to increase margins, they adjusted the elements to which their retailers were least sensitive -- thus minimizing loss of volume.

Second, over time they decreased the amount of discounting in the waterfall elements that just didn't matter to retailers, shifting part of that discounting to those elements that really influenced retailer buying decisions. By doing so, Tech-Craft made sure it was getting the most retailer buying preference for its discount dollars.

Tech-Craft management became quite skillful in the fine art of "waterfall engineering" -- that is, fine-tuning the components of its pocket price waterfall to optimize the effect on buyer behavior. Not unlike Castle, Tech-Craft reaped rich rewards from its newfound skills and initiatives in transaction pricing. Within a year, the company had not only grown its unit volume by over 11 percent but also had increased average

pocket price levels by 3.5 percent, resulting in a 60 percent operating profit improvement.

Capturing untapped transaction pricing opportunity

While the specific moves required to capture untapped transaction pricing opportunity can vary widely from company to company, the most useful improvement actions fall into three general areas:

1. Manage the pocket price band. An understanding of pocket price and its variability across customers and transactions provides the bedrock of successful transaction price management. The entire pricing process should be managed toward pocket price realization rather than invoice price or list price. Pocket price should be the sole yardstick for determining the pricing attractiveness of products, customers, and individual deals. All price measurement and performance gauges should be recast with pocket price used as the base for calculating revenues. As the Castle Battery Company case demonstrates, considering business from this pocket price viewpoint can drastically change a company's perspective on the relative attractiveness of segments, customers, and transactions.

Creating information systems that correctly measure and report pocket price is problematic for many companies. Elements of the waterfall often reside on different systems or do not exist in data systems at all. These difficulties notwithstanding, companies should make the investment to produce a correct and comprehensive pocket price calculation.

Managers must resist the temptation to leave elements out of the waterfall because they are difficult to calculate or inconvenient to include from an information systems standpoint. Effective transaction price management often requires tough customer initiatives, but incorrect or incomplete pocket price reporting gives managers an excuse not to initiate necessary pricing policies.

Once a company establishes a pocket price measure, it should drive explicit sales and marketing steps off the "tails" of the pocket price band. Excellent transaction pricers look to the pocket price band and target specific actions for the best and worst 10 to 20 percent of transactions and customers. Marketing and sales should target customers with transactions at the high end of the price band for increased volume. These departments should also identify clients at the low price end, marking them for actions that will result in either improved price levels or their termination as customers.

Management should not exclude any low-price customers, regardless of their history or relationship with the company, from such corrective actions. The hard pocket price numbers must determine which customers require remedial price action. Price band management initiatives quickly lose credibility and momentum if exceptions are made that allow favored customers to languish at the low end of a pocket price band.

2. Engineer the pocket price waterfall. The best transaction pricers understand the leverage of waterfall engineering. Despite the fact that a dollar anywhere along the waterfall affects a company's pocket price and profit equally, the Tech-Craft case demonstrates that not all waterfall elements equally influence customer buying. A knowledge of which pieces of the waterfall matter to customers can guide not only how a company changes overall price and price structure but also how it negotiates with individual customers.

Managers shouldn't be at all surprised if different sets of waterfall elements are important to different customer segments or different channels of distribution. Sales representative input can further enrich understanding of specific customer sensitivity to waterfall elements.

Each component of a company's pocket price waterfall deserves careful and explicit management. Top managers should set a quantifiable objective for each element of the pocket price waterfall, and if that goal is not achieved, they must change or even discontinue that element.

Too many companies put in place a waterfall element like annual volume

bonuses and leave it there unchanged, regardless of its effectiveness in influencing customer behavior. The sales and marketing organization should set hard objectives for each waterfall element. For example, the objective for an annual volume bonus might be to cause sales volume to grow at an average of 8 percent annually in existing accounts.

A company should take an annual snapshot of the results of its efforts. If it fails to meet its objective for a waterfall element, it should either adjust or eliminate that element. Excellent transaction pricing companies, like Tech-Craft, routinely re-engineer their pocket price waterfalls and make each piece of the waterfall work for them.

3. Get organizational involvement and incentives right. With percentage points of return on sales in the balance, transaction pricing merits broad organizational involvement; it is too important for even the president and CEO of a business to ignore. Companies that are best at transaction price management have general managers who understand its importance, set specific goals for transaction price improvement, and monitor those goals through regular and concise transaction price performance reports.

Exhibit 7 shows a quarterly "pocket price source of change" report that the president of Castle now uses to monitor the waterfall for major product lines. From it he can quickly see changes in average pocket price and understand the key sources of those changes along the price waterfall. He can recognize and reward pocket price improvement, question price performance shortfalls, and communicate to his organization that transaction pricing is important to him.

Deeper in the organization, superior transaction price performance seldom occurs unless top management offers appropriate incentives to key pricing influencers and decision makers like pricing managers, salespeople, sales managers, and marketing managers. Individuals incur an unavoidable risk when they strive for higher prices from customers -- the risk of alienating the customer or losing the business altogether. It's always easier and less risky to price low. To offset the risk of pushing for higher price, tie incentives like compensation to pocket price realization.

Salesforce incentives based on total sales revenue are not enough of an inducement for salespeople to push for higher prices. The pricing leverage for sales revenue-based compensation is always out of balance -- a 5 percent decrease in price, for instance, will cause only a 5 percent decrease in a salesperson's compensation. But assuming average company economics, it will engender a 60 percent operating profit decrease for that transaction. Only sales incentive plans that abundantly reward above-average price realization and deeply penalize below-average price levels will draw smart and profitable transaction price management from a salesforce.

Even if salespeople have no explicit pricing authority, some salesforce incentive for transaction price realization may still be prudent. Salespeople are usually the front-line negotiators and the carriers of a company's benefit and value message. They know the discounting limits their company will approve and will drop to those limits unless adequately compensated to do otherwise.

The salesforce role in transaction price management is simply too important for much progress to be made without their committed buy-in and support. In both the Castle and Tech-Craft cases, pocket price-based incentives for all pricing decision makers, including the salesforce, fueled ongoing improvement in transaction pricing performance.

The transaction pricing opportunity is real and achievable for most companies today. The investment and risk of capturing this opportunity are low; the keys to success are mostly executional -- doing a number of small things right. What is more, advances in information technology tend to make many of these small things easier than ever to do. And, as the Castle and Tech-Craft cases show, the payoff is extremely high, both in near-term and

sustainable profit improvement and in valuable strategic insights. With its extremely favorable risk/effort/reward profile, improving transaction price management may be one of the most attractive and overlooked profit enhancement opportunities available to most managers.

* Editor's note: For an introduction to transaction price management, see Philip J. Hawk and Michael V. Marn, "Memo to a CEO: Managing transaction pricing," The McKinsey Quarterly, 1991 Number 1, pp. 90-105.

* Arleigh W. Walker, "How to Price Industrial Products," Harvard Business Review, September-October 1967, p. 125; Elliot B. Ross, "Making Money with Proactive Pricing," Harvard Business Review, November-December 1984, p. 145.

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